United Nations DP/2008/53

Executive Board of the United Nations Development Programme and of the United Nations Population Fund

Distr.: General
25 August 2008

Original: English

Second regular session 2008
8 to 12 September 2008, New York
Item 2 of the provisional agenda
Financial, budgetary and administrative matters

The role of UNDP in the changing aid environment at the country level* (Supplementary report to DP/2008/36)

Summary

At its June 2008 session, the Executive Board "*endorse[d]*, in principle, a four-year pilot period, starting in September 2008, for enabling UNDP financial contributions to pooled funding and sector budget support, on a case-by-case basis, upon the request of the recipient country and in accordance with the mandate and comparative advantage of UNDP, within the limitations and provisions provided in document DP/2008/36" (decision 2008/24).

In the same decision, the Executive Board requested UNDP to "prepare an additional report for approval by the Executive Board at its second regular session 2008, including: (a) an update on the common approach among the members of the United Nations Development Group towards the changing aid environment; (b) an analysis of the role of UNDP in the new aid environment, also in relation to other development partners, while emphasizing the further efforts of UNDP to achieve greater harmonization and alignment; and (c) a further elaboration of the criteria of engagement in sector budget support and pooled funding, and indicators to measure the effectiveness of this new aid modality". The present report responds to that request.

Elements of a decision

The Executive Board may wish to: (a) approve this report as a follow-up to document DP/2008/36 and as a response to the request of Executive Board Decision 2008/24 for an additional report; and (b) encourage UNDP to pursue this approach with the United Nations Development Group to ensure synergy and common approaches in the United Nations system response to the changing aid environment.

*The compilation of data required to provide the Executive Board with the most current information has delayed submission of the present report.

08-49118 (E) 160908

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I. Introduction

1. In response to the request of the UNDP Executive Board at its annual session 2008, the present report outlines the UNDP response to the changing aid environment, and its engagement with the United Nations Development Group (UNDG) on a common approach in this context. The report also provides indicators for measuring effectiveness and evaluating the process by which the results of the pilot period for UNDP engagement in sector budget support and pooled funding would be evaluated (see decision 2008/24, paragraph 6).

2. The positions expressed in the present report are based on the spirit and the letter of the General Assembly resolution on the Triennial Comprehensive Policy Review of operational activities for development of the United Nations system (General Assembly resolution 62/208) as well as that of the UNDP strategic plan, 2008-2011 (DP/2007/43/Rev.1). The report also reflects – as does the Triennial Comprehensive Policy Review – the related international commitments and agreements on financing for development, the Millennium Development Goals, and efforts to improve the quality of aid.[1]

3. The present report builds on document DP/2008/36 concerning UNDP engagement in direct budget support and pooled funds, which was submitted to the Executive Board at its annual session 2008.

4. The inclusion of direct budget support within the spectrum of aid modalities is seen as a further step towards strengthened country ownership and capacities, and increased rationality and cost-effectiveness in the management of development assistance. Direct budget support is defined as a method of financing the budget of a partner country through a transfer of resources from an external financing agency to the national treasury of the partner government (see DP/2008/36). It supplements public expenditure on nationally agreed priorities. General budget support is an unearmarked contribution directed at overall government policy and expenditures, while sector budget support is an earmmarked contribution to the national budget towards sector- or programme-specific results.

5. Fund management arrangements under direct budget support can result in a pooled fund arrangement (also called basket funds), relating to a specific sector, thematic programme or plan. Pooled funds involve a group of donors agreeing to pool their resources collectively, under a common fund management arrangement, led by a designated donor or government agency.[2] Pooled funds may or may not make use of government procedures. Hence, sector budget support is a specific type of pooled funding that (a) supports a whole sector programme; and (b) makes full use of government budget execution, procurement and financial management systems. The progression towards pooled funds emanates from countries that have experienced common and agreed sector plans and programmes, where government and donor partners have come together under a common strategic policy and programme

[1] Monterrey Financing for Development Consensus (2002), World Summit Outcome Document (2005). The Financing for Development commitments, including the quality of aid, are key financial instruments linked to development effectiveness objectives and achievement of the Millennium Development Goals.

[2] Such an arrangement often remains outside the treasury, funding a subset of a sector strategy or national programme. Funds can be pooled to finance a single activity, project, a sub-programme, or a whole sector programme.

framework. Providing funds in a common pool that supports an agreed common sector approach or plan is therefore seen as a natural extension in this process, i.e., from a common plan and programme to a common funding window to support that sector plan or programme. This further enhances harmonization and alignment at country level.

II. A common approach among the United Nations Development Group in the changing aid environment

> "[…] operational activities for development of the United Nations system should be, inter alia, their universal, voluntary and grant nature, their neutrality and their multilateralism, as well as their ability to respond to the development needs of programme countries in a flexible manner, and that the operational activities are carried out for the benefit of programme countries, at the request of those countries and in accordance with their own policies and priorities for development"
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> *Source:* Triennial Comprehensive Policy Review, A/RES/62/208, Introduction, paragraph 3

6. The members of the UNDG recognize that the current aid environment offers new opportunities for efficient development financing through a series of international commitments on aid quality and a diversity of aid modalities and development assistance actors. However, the persisting challenges remain, which are to ensure more coherence and harmonization among multiple development partners, strong country leadership, alignment of aid with the country-defined development plans and priorities, as well as the use of national systems for delivery of aid.[3]

7. In February 2005, UNDG issued a position paper titled "The role of the United Nations system in a changing aid environment: sector support and sector programmes". This paper set out four key functions of the United Nations system in sector programmes: (a) conceptual role/coherence with regards to policy dialogue; (b) convening critical meetings and processes; (c) capacity development, such as strengthening financial and programme management systems; and (d) contribution, recognizing that while financial contributions are not the defining factor of United Nations engagement, there can be circumstances where a financial contribution is appropriate. UNDG is currently reviewing a and analysing the paper and working to harmonize financial regulations and rules.

8. In January 2008, UNDG published another, broader joint paper on this topic with the title "The role of the United Nations in the changing aid environment". That paper brings together country-level experience and lessons stemming from various measures undertaken at the UNDG level. While noting that the United Nations system, as a trusted partner, has made significant contributions to shaping and responding to the changing aid environment, it acknowledges that the United Nations system has to meet the remaining challenges mentioned above. The paper will be followed by a guidance note for United Nations country teams to assist them in addressing those challenges.

[3] See papers presented in the following paragraphs, available at http://www.undg.org/index.cfm?P=219; assessments conducted by UNDP and UNDG; and subsequent reports (2006-2008).

9. The role of the United Nations development system at country level is neither that of a major financier nor that of traditional donor.[4] the United Nations development system facilitates the access of countries to sources of development finance; provides policy and technical services, as needed; and strengthens national capacities to respond to continuing and emerging challenges. The United Nations Development Assistance Framework (UNDAF) provides the basis for United Nations development system financing for policy and programme support, This instrument outlines the overall United Nations support to the development priorities of each country.

10. The resident coordinator system and United Nations country teams are tasked with intensifying capacity development interventions in support of country-owned aid policy, national aid coordination mechansims and aid management (including aid management systems). Policy and technical services provided to support transparent financial management, the promotion of peer learning, and capacity development through cross-country exchanges in areas such as leadership skills, diagnostic and implementation capacities, knowledge services and training, as well as institutional reform, are capacity-enhancing efforts funded through individual projects as well as through sector programmes financed using the mechanism of pooled funds.

11. The above-mentioned services are offered with a common recognition of the comparative advantage of the United Nations development system, with its neutrality and universality, in a changing aid environment and in line with the Triennial Comprehensive Policy Review, 2007. This makes possible critical inter-governmental actions in which the characteristics of multilateralism are most in demand – to service global norms and standards; to support global public goods and services; and to help address development challenges, such as post-conflict situations, as well as emerging challenges, such as climate change and food crises. The UNDG approach and response to the changing aid environment recognizes country specificity and the need to adapt of approaches and instruments to the local aid and development finance context.

III. UNDP response to the changing aid environment

12. The goal of UNDP is to advance human development by expanding opportunities and deepening people's ability to reach their development potential. To make that happen, the core contribution of UNDP is strengthening national capacities in a way that supports human development. UNDP support, whether financed through nationally-executed and implemented programmes and projects or through sector budget support funds and pooled funds, remains the same: (a) within its given mandate areas, (b) in sectors where it is already participating; and (c) in connection with its capacity development role and support at the country level. ('Sector' in this respect refers to a programmatic area in which UNDP is already working.)

13. UNDP supports and contributes as a primary partner to the UNDG efforts described in the chapter II, above. UNDP co-chaired the UNDG working group on aid effectiveness and has been tasked to lead, with UNFPA, the follow-up workstream on aid effectiveness in the newly established UNDG working group on programme issues.

[4] The total official development assistance channeled through the United Nations annually is approximately $17.2 billion (2006; *Comprehensive statistical analysis of the financing of operational activities for development of the United Nations system for 2006*; A/63/71).

14. In complementarity with the work of the United Nations system and other development partners, UNDP interventions to enhance aid effectiveness focus on strengthening country capacities to design national aid policies and plans; map external resource needs; access development finance for ongoing and emerging needs; and strengthen national systems, irrespective of the funding modality. In line with the common UNDG approach,,[5] the emphasis is on strengthening national capacities by facilitating capacity assessments and formulating capacity development strategies intended to strengthen country aid management and implementation. This includes the coordination of development finance and support to national monitoring and accountability instruments to track the impact of aid. Furthermore, through its expertise and substantive contribution, UNDP, upon demand from host country governments, supports resident coordinators in determining the role of the United Nations system and its positioning in the aid environment.

15. In this context, and based on increasing demand, UNDP is helping to facilitate and negotiate aid modalities, including direct budget support.[6] This is well in keeping with the Triennial Comprehensive Policy Review resolution of 2004, which asked the United Nations system to "support national capacities for the management of various aid modalities, including system-wide approaches and budget support" (A/RES/59/250). The 2007 resolution (A/RES/62/208, paragraph 103) takes this resolution one step further, and explicitly "[e]ncourages that the United Nations development system be invited to participate, ex officio, in current and new aid modalities and coordination mechanisms at the request of the programme country, and invites the United Nations development system to enhance its participation in this regard". While acknowledging that direct budget support is not the core business of UNDP, UNDP recognizes it as a development finance instrument that promotes national ownership, transparency and harmonization in aid allocations, and alignment with national plan and budget priorities.

16. UNDP will not engage in general budget support, which is a general transfer to the national budget. The rationale for UNDP engagement in sector budget support and pooled funds is to respond to growing country demands for capacity development and for expanded inclusion of UNDP in efforts towards harmonization and alignment. UNDP will only engage in pooled funding in areas or sectors in which it is already present through a separate project (see DP/2008/36).

17. UNDP support can take the form of a capacity development initiative and policy advisory services through (a) a standard UNDP project; (b) managing a pooled fund upon request by a government; (c) signing on to a sector budget support fund or a pooled fund as a non-fund provider or "signatory withouth fiduciary obligation", or becoming a non-signatory with observer status in the respective partnership group; or (d) a financial contribution to a sector budget support fund or to a pooled fund. Alternatively, it could be an appropriate combination of these options if so required (DP/2008/36).

18. The value-added role of UNDP engagement in sector budget support and pooled funds, as a response to country demand, is above all to strengthen two aspects of country capacities: (a) the capacities of the national entities negotiating, managing and

[5] This approach was also espoused in the UNDG 'Position Statement on Capacity Development' (December 2006) and the 'UNDG Capacity Assessment Methodology User Guide' (May 2008).

[6] Evidenced through regular electronic network discussions among a 250-plus strong community of aid effectiveness practitioners; feedback on direct budget support and pooled funds from numerous country offices.

overseeing sector-wide approaches in UNDP mandate areas, as set out in the UNDP strategic plan, 2008-2011; and (b) involvement in sector budget support and pooled funds that support such sector-wide approaches to ensure that the totality of the support focuses on national capacity development, and is not an add-on or de-linked effort. Participation in sector budget support and pooled funds in the areas of the UNDP mandate is,therefore seen as a natural corollary to its capacity development role and focus. ('Sector' in this respect refers to a programmatic area in which UNDP is already working.)

IV. Implementing UNDP engagement in sector budget support/ pooled funds and measuring the effectiveness of the pilot period

19. Document DP/2008/36 sets out the limitations, criteria and provisions for UNDP to engage in sector budget support and pooled funding. UNDP will issue internal operational guidance to its country offices specifying the criteria outlined in document DP/2008/36, as well as operational and reporting requirements for direct financial contributions, including checklists in that regard.

20. The overarching principles for UNDP engagement are that sector budget support and pooled funding must: (a) contribute to strengthening partner countries' ownership; (b) enhance the performance and accountability of programme countries' public financial management systems; (c) seek to minimize transaction costs incurred by participating countries; (d) be delivered in a way that enhances the predictability of resources and reduces their volatility.

21. Robust monitoring and quality assurance capacities will be required in country offices, to keep abreast of, and fully participate in, the monitoring of development results and review process. The above-mentioned guidelines and checklists will support country monitoring and reporting.

22. Any memorandum of understanding for a sector budget support fund or a pooled fund that UNDP is considering becoming engaged in must include agreed criteria on joint monitoring and evaluation of contributions to sector budget support funds and pooled funds, minimizing separate reviews and evaluation missions. During the pilot period, the annual report of the Administrator will include a progress report on the pilot, and the annual review of the financial situation will contain an overview of financial contributions to pooled funding and sector budget support.

23. At the end of the pilot period, UNDP will prepare a report that will include:

(a) An evaluation of the pilot on the basis of the criteria outlined in document DP/2008/36 and further specified in this document; and

(b) An update on UNDP efforts towards the harmonization of regulations and rules under consideration in the UN, including the changes needed to allow participation in pooled funding and sector budget support.

24. To measure the value and effectiveness of UNDP engagement in sector budget support and pooled funding during the pilot period, the comprehensive evaluation of the pilot period involving major stakeholders will focus on assessing the following parameters of organizational effectiveness:

(a) Has UNDP engagement in sector budget suport and pooled funds contributed to a greater policy and advocacy role for UNDP in the given mandate area?

Indicators: UNDP, as partner in the sector budget support or pooled fund, has increased engagement with national partners on policies and programmes underpinning that sector strategy/plan; UNDP is involved in the monitoring and evaluation of sector results.

(b) Has UNDP engagement in sector budget support and pooled funds contributed to an increased use of country systems, as well strengthened capacities of the relevant country systems – for example, procurement, public financial management, and audit?

Indicators: UNDP has increased its use of national systems; UNDP has contributed to strengthening related country capacities through tailor-made capacity development initiatives; the performance and accountability of public financial management systems in programme countries has been enhanced.

(c) Has UNDP engagement in sector budget support and pooled funds resulted in economies of scale and thus reduced transaction costs for the government and for UNDP freeing up capacities, and if so, how?

Indicators: Extent of reduction in transaction costs to determine business efficiencies; change in business processes resulted in increased time and cost efficiencies and thus a reduced burden on the government vis-à-vis management and administration, in relation to separate project management costs.

(d) Has UNDP engagement in sector budget support and pooled funds made a difference in harmonization and alignment at the country level?

Indicators: The involvement of the United Nations development system in that sector, through the sector budget support or pooled fund, is more aligned and harmonized; UNDP involvement and processes in the area of the sector budget support or pooled fund is more aligned with national systems; joint missions, joint evaluations, joint reviews, and joint reporting have increased, freeing up government capacities.

(e) In case of direct financial contributions to a sector budget support fund or a pooled fund, is there sound monitoring and oversight in the respective fund, in keeping with the relevant memorandum of understanding?

Indicators: The roles for UNDP as detailed in the memorandum of understanding are adhered to by all parties; the UNDP country office has the capacity to monitor and oversee UNDP engagement in the sector budget support or pooled fund in that sector.

25. Pursuant to decision 2008/24, and within the limitations and provisions set forth in this report and in document DP/2008/36, UNDP will proceed with the four-year pilot period, starting in September 2008. UNDP will organize regular informal consultations with its Executive Board on progress with the pilot and the preparation of the reports requested in the present decision.